Internal Revenue Service

Number: **201322023**
Release Date: 5/31/2013

Index Number: 61.00-00, 461.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
CC:ITA:B04
PLR-138009-12

Date:
February 28, 2013

TY:

Dear

This letter responds to your request, dated September 4, 2012, for a ruling concerning whether

STATEMENT OF FACTS:

Taxpayer is a stockholder-owned corporation, organized under Title III of the Emergency Home Finance Act of 1970. Congress chartered Taxpayer in 1970. Taxpayer's annual accounting period is the calendar year and its overall method of accounting is an accrual method.

Taxpayer purchases residential mortgages and mortgage-related securities in the secondary market and securitizes them into mortgage-backed securities (MBS) that it sells to investors. For example, Taxpayer purchases mortgage loans and issues to unrelated investors certificates representing interests in pools of those mortgage loans. Taxpayer generally guarantees timely payment of principal and interest on MBS.

Taxpayer earns a guarantee fee from its activities by insuring that investors receive timely principal and interest payments on MBS, regardless of the credit performance of the underlying mortgages. Generally, a portion of the interest on each mortgage loan pooled in an MBS is paid as a servicing fee to the servicer and a guarantee fee to

[1]

APPLICABLE LAW AND ANALYSIS:

Section 61(a) of the Internal Revenue Code generally provides that gross income means all income from whatever source derived, including (but not limited to): (1) compensation for services, including fees and similar items; (2) gross income derived from business; (3) gains derived from dealings in property; and (4) interest.

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Section 162(a) provides a deduction for all ordinary and necessary business expenses paid or incurred during the taxable year in carrying on a trade or business.

Section 461(a) provides that the amount of any deduction or credit is taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(2) of the Income Tax Regulations provides that under an accrual method of accounting, a liability is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which all events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. *See also* § 1.446-1(c)(1)(ii)(A).

Section 1.461-4(g) provides guidance with respect to certain liabilities for which payment is economic performance (i.e. payment liabilities). Section 1.461-4(g)(1)(i) provides, in part, that in the case of liabilities described in paragraphs (g)(2) through (g)(7) of this section, economic performance occurs when, and to the extent that, payment is made to the person to which the liability is owed.

Section 1.461-4(g)(7) provides that in the case of a taxpayer's liability for which economic performance rules are not provided elsewhere, economic performance occurs as the taxpayer makes payments in satisfaction of the liability to the person to which the liability is owed.

Section 1.461-5(a) provides that except as otherwise provided in paragraph (c) of this section, a taxpayer using an accrual method of accounting may adopt the recurring item exception described in paragraph (b) of this section as a method of accounting for one or more types of recurring items incurred by the taxpayer. *See also* § 461(h)(3).

Section 1.461-5(c) provides that the recurring item exception does not apply to any liability of a taxpayer described in, among others paragraphs, paragraph (g)(7) (other liabilities) of § 1.461-4.

In determining what constitutes income, the Supreme Court has stated that § 61(a) brings within the definition of income any "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426 (1955). *See also Burke v. United States,* 504 U.S. 229, 233 (1992). The Court has also consistently held that when "a taxpayer acquires earnings, lawfully or unlawfully, without the consensual recognition, expressed or implied, of an obligation to repay and without restriction as to their disposition, 'he has received income….' " *James v. United States,* 366 U.S. 213, 219 (1961), *quoting North American Oil Consolidated v. Burnet*, 286 U.S. 417, 424 (1932).

In a more recent case, the Court has held that in "determining whether a taxpayer enjoys 'complete dominion' over a given sum, the crucial point is not whether his use of the funds is unconstrained during some interim period. The key is whether the taxpayer has some guarantee that he will be allowed to keep the money." *Commissioner v. Indianapolis Power & Light Co.,* 493 U.S. 203, 210 (1990).

When a taxpayer receives money or property for someone else's use or benefit, such receipt is not income to the taxpayer. In Rev. Rul. 74-321, 1974-2 C.B. 16, a regulated farm credit production association received credit insurance premiums from member/borrowers for payment to an insurer. The association also received dividends from the insurer that were used for the benefit of members to reduce future premiums. The Service held that neither the payments nor the dividends received by the association are includible in the income of the association because the payments were earmarked and retained for the benefit of the member/borrowers, not the association, from the time received until expended. *See also Seven-Up Co. v. Commissioner,* 14 T.C. 965 (1950), *acq. in result,* 1974-2 C.B. 1 (concluding that a manufacturer's receipt of funds from participating bottlers for a national advertising campaign was includible in gross income because the funds benefitted the payors, not the manufacturer).[2]

Similarly, if a taxpayer receives a payment under a binding legal obligation to remit the payment to another, or as an agent receiving amounts on behalf of a principal, the taxpayer is deemed to be a mere conduit of those funds and is not required to include the payment in income. *See* Rev. Rul. 76-479, 1976-2 C.B. 20; Rev. Rul. 69-274, 1969-1 C.B. 36; Rev. Rul. 65-282, 1965-2 C.B. 21 and Rev. Rul. 58-220, 1958-1 C.B. 26, for instances in which the IRS has held that a taxpayer does not have gross income upon receipt of a payment because the taxpayer receives the payment as a conduit for the ultimate recipient.

In this case, Taxpayer is not allowed to keep the TCCA Fees it collects. Instead, Taxpayer has a binding legal obligation to collect and turn over the TCCA Fees to Treasury and collects them as a mere conduit for Treasury. Thus, Taxpayer's receipt of

[2] The Service acquiesced only in the result of *Seven-Up Co.* on the ground that the correct party to be charged with the income (and deductions for the advertising) was an unincorporated association consisting of the manufacturer and bottlers. The action on decision states that the entity has income in the amounts contributed by the bottlers because it "has the power to exercise day-to-day business judgments and to control the details respecting the manner in which the funds shall be expended in achieving the overall purpose" of the fund. 1973 AOD LEXIS 264 (December 3, 1973).

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. This is supported by Rev. Rul. 74-321, which concluded that since a credit association acted as an agent for borrowers to collect and pay insurance premiums and to hold insurance dividends it therefore "is not required to include the payments by the borrowers or the insurance dividends in its gross income *and it is not entitled to a deduction* for the annual premium payment" (emphasis added). In contrast, expenditures are deductible in circumstances where a determination is made that the taxpayer is not an agent or conduit for the ultimate recipient. *See* Rev. Rul. 66-377, 1966-2 C.B. 21 (university faculty members who engage in private practice must report fees as income since they were not acting as agents of university but may deduct fees they were contractually required to turn over to the university under § 162).

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RULINGS:

DISCLAIMERS:

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

You must attach a copy of this letter to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Michael J. Montemurro
Branch Chief, Branch 4
(Income Tax & Accounting)

cc: